ORIGINAL

ORIGINAL

SQUIRE SANDERS | LEGAL COUNSEL WORLDWIDE

SQUIRE, SANDERS & DEMPSEY L.L.P.
1201 Pennsylvania Avenue, N.W.
P.O. Box 407
Washington, D.C. 20044-0407
Office: +1.202.626.6600
Fax: +1.202.626.6780

EX PARTE OR LATE FILED

Direct Dial: +1.202.626.6838
jnadler@ssd.com

June 1, 2000

VIA COURIER

Ms. Magalie Roman Salas
Secretary
Federal Communications Commission
445 Twelfth St., SW
Counter TW - A325
Washington, DC 20554

Re: *Ex Parte* Presentation In the Matter of GTE Corporation, Transferor, and Bell Atlantic Corporation, Transferee, for Consent to Transfer Control (CC Docket No. 98-184) /

Dear Ms. Salas:

Pursuant to 47 C.F.R. § 1.1206(b), this letter is to inform you that five *ex parte* presentations were made regarding issues in the above-referenced proceeding.

On May 30, 2000, Jonathan Jacob Nadler of Squire, Sanders & Dempsey, LLP, representing the Information Technology Association of America (ITAA), William Warner, Chairman of ITAA Telecommunications Policy Committee, and Mark Uncapher, Vice President of Information Services and Electronic Commerce of ITAA met with Dorothy Attwood, Senior Legal Advisor to Chairman Kennard.

On May 31, 2000, Jonathan Jacob Nadler of Squire, Sanders & Dempsey, LLP, representing the Information Technology Association of America (ITAA), William Warner, Chairman of ITAA Telecommunications Policy Committee, and Mark Uncapher, Vice President of Information Services and Electronic Commerce of ITAA met with: Jordon Goldstein, Legal Advisor to Commissioner Ness; Rebecca Beynon, Legal Advisor to Commissioner Furchtgott-Roth; and Sarah Whitesell, Legal Advisor to Commissioner Tristani.

The issues addressed in each meeting are outlined fully in the attached written *ex parte* presentation, which was provided during the meetings. In addition, a copy was delivered to Kyle Dixon, Legal Advisor to Commissioner Powell.

In accordance with Section 1.1206, an original and two copies of this letter and attachment are being submitted to the Secretary's office on this date. Please address any questions regarding this matter to the undersigned.

Respectfully submitted,

Jonathan Jacob Nadler

Jonathan Jacob Nadler
Counsel for Information Technology
Association of America

Enclosure

cc: Dorothy Attwood, Senior Legal Advisor to Chairman Kennard
Jordon Goldstein, Legal Advisor to Commissioner Ness
Rebecca Beynon, Legal Advisor to Commissioner Furchtgott-Roth
Kyle Dixon, Legal Advisor to Commissioner Powell
Sarah Whitesell, Legal Advisor to Commissioner Tristani
Janice Myles, Policy and Program Planning Division, Common Carrier Bureau
Julie Patterson, Policy and Program Planning Division, Common Carrier Bureau
William Warner, Chairman of ITAA Telecommunications Policy Committee
Mark Uncapher, Vice President of Information Services and Electronic Commerce of ITAA

THE PROPOSED "OPTION AGREEMENT" UNLAWFULLY WOULD GIVE VERIZON "THE EQUIVALENT" OF AN EIGHTY PERCENT EQUITY INTEREST IN GENUITY

May 30, 2000

- The Commission Need Not Adopt the "Absolutist" Position Advanced by AT&T, and Should Not Adopt the Standardless Approach Advocated by Bell Atlantic/GTE

  -- Regardless of the treatment of option agreements under bankruptcy law, securities regulations, or accounting rules, the Commission need not find that all option agreements constitute equity interests within the meaning of the Communications Act

  -- While the Communications Act does not specifically address the treatment of option agreements, the Commission does not have complete "discretion" to permit any arrangement that it considers to be good industrial policy

- The Commission Should Interpret the Prohibition on a BOC Holding "the Equivalent" of an Equity Interest in Excess of Ten Percent in an In-region, Inter-LATA Service Provider in a Manner That Will Advance the Goals of Section 271

  -- In enacting Section 271, Congress barred the BOCs from owning an equity interest of more than ten percent in any entity that provides in-region, inter-LATA services because allowing a BOC to have such interests would:

    * eliminate the BOC's only incentive to open its local markets to competition

    * give the BOC an incentive to use its market power to discriminate in favor of the inter-LATA service provider

  -- Congress further recognized that certain arrangements, which do not constitute equity interests, would give a BOC the economic incentives act in *precisely* the same manner as would an equity interest; Congress therefore barred a BOC from entering into such "equivalent" arrangements

  -- Thus, in order to determine whether the proposed Verizon/Genuity agreement would give Verizon the equivalent of an equity interest in excess of ten percent in Genuity, the Commission must look at the economic substance of the agreement – rather than its legal form – to assess whether the agreement would reduce Verizon's incentives to open its local markets and give Verizon an incentive to discriminate in favor of Genuity

- The Proposed "Option Agreement" Would Provide Verizon with an *Immediate Economic Interest* in Genuity Equal to Eighty Percent of Genuity's Value

  -- Bell Atlantic and GTE's effort to style the proposal as an option agreement is a transparent sham

    * There is no reasonable doubt that the "contingency" would occur; Verizon has set the bat shameless low: it will have at least *eleven years* after the adoption of the Telecommunications Act to bring itself into compliance with Section 271

    * There also is no reasonable doubt that Verizon ultimately would exercise the option; doing so would allow it to increase its equity interest from 9.5 to 80 percent at no additional cost

  -- Once it exercised the option, Verizon would be able to capture the appreciation in Genuity, thereby putting it in the same economic position that it would have been in if it had held an 80 percent equity interest in Genuity from the outset

  -- Consequently, as Bell Atlantic and GTE have conceded, financial markets would value Verizon's interest in Genuity at 80 percent of Genuity's value

- Because of its Economic Effect, the Proposed "Option Agreement" Would Cause Verizon to act in *Precisely* the Same Manner as Would Allowing Verizon to Take an Immediate 80 Percent Equity Interest in Genuity

  -- Verizon's incentive to rapidly open its local markets to competition would be reduced

    * The strongest incentive for Verizon rapidly to open its local markets to competition is the one created by Congress: barring it from owning more than a ten percent equity interest (or its equivalent) in an in-region, inter-LATA service provider until it has fully opened its local markets to competition

    * The proposal would not create compliance incentives by subjecting Verizon to significant risk

      + There no realistic chance that Verizon would be limited to a 10 percent equity interest in Genuity: to meet the 50 percent threshold within five years, Verizon would only need to open its local markets in two additional States within five years

+ The possibility that Verizon would be required to divest the option, and would have its return on its investment in Genuity "limited" to the return on an investment in the S&P 500 if its does not meet the 95 percent threshold within six years, does not create a significant risk; during the last five years, the average return on the S&P has been 26.3 percent per year – a very competitive return for an established telecommunications company

* The proposed option agreement would actually create incentives for Verizon's to delay open its markets for several years; allowing Verizon to ultimately capture the 80 percent of the appreciation in the value of Genuity during the period prior to the exercise of the option would reward the company – which should be in full compliance with Section 271 *today* – for delaying full compliance until more than a decade after the adoption of the Telecommunications Act

-- Verizon would have the incentive and ability to discriminate in favor of Genuity

* In conducting its business, Verizon would operate on the assumption that it ultimately would acquire Genuity – indeed, the applicants would not have proposed this arrangement if they did not believe it was virtually certain that they could satisfy the contingency; consequently, Verizon would have an economic incentive to discriminate in favor of Genuity in order to increase its value; to the extent that the proposed arrangement does create an incentive for Verizon to open its local market, thereby allowing it to obtain an 80 percent stock interest in Genuity, this would compound Verizon's incentive to discriminate in favor of Genuity

* Verizon could discriminate in favor of Genuity in a number of ways:

  + As Bell Atlantic/GTE concede, Verizon could discriminate in favor of Genuity in the provision to high-capacity point-to-point local circuits

  + Verizon could provide Genuity with preferential access to copper loops necessary to provide Genuity's new DSL service

  + Verizon could "steer" its large business telecommunications customers to Genuity

  + Verizon could provide service on favorable terms to customers of its dial-up Internet access service that select Genuity as their Global Service Provider

  + Verizon could provide service on favorable terms and conditions to its unaffiliated ISP customers that hand-off traffic to Genuity

  * The Section 271 application review process would not provide an adequate deterrent to discrimination in favor of Genuity

    + Discrimination may take subtle forms, which would be difficult to detect

    + To the extent detected, such discrimination might not provide the basis for denial of Verizon's Section 271 applications; the Commission may consider only whether Verizon has satisfied the 14-point competitive checklist in any given State; certain forms of discrimination are outside the scope of the checklist

    + Even where the checklist addresses relevant forms of discrimination that Verizon could use to favor Genuity (such as loop provisioning), the Commission may only consider whether, at the time of the application, Verizon is in compliance; Verizon could engage in discrimination for several years, correct the problem on the eve of filing its Section 271 application, and thereby satisfy the requirements of the competitive checklist

- Allowing Verizon to Enter into the Proposed "Option Agreement" Would Set a Dangerous Precedent

  -- The BOCs are likely to propose additional "option agreements" to acquire providers of in-region, inter-LATA voice and inter-LATA information services; such agreements are likely to contain even-less-challenging "contingencies"

  -- Permitting such arrangements would completely undermine the market-opening regime established by Congress and enforced by the Commission

- There is No Basis For the Commission to Apply the Section 271 Prohibition Less Stringently in the Present Case Because it Involves a Data-Oriented Service; Such an Approach Would be:

  -- inconsistent with the Telecommunications Act: Section 271 is not limited to inter-LATA voice services; it prohibits a BOC from providing *any* in-region inter-LATA *telecommunications or information services* before the BOC complies with the competitive checklist

  -- inconsistent with FCC precedent: The agency has squarely held that Section 271 applies to data-oriented "advanced telecommunications services"

-- unsound as a matter of policy: Data services are the BOCs' most significant growth area; requiring the BOCs to open their local markets before being allowed to provide in-region, inter-LATA data services is the *most effective means* to create incentives for prompt Section 271 compliance

--- administratively unworkable: increasingly, data-oriented packet services will be used to provide both voice and data; application of different rules to voice and data services will result in artificial, market-distorting regulatory line-drawing

- The proposed "Option Agreement" Would Not Have Been Permitted Under the Three-Part Test Established Applicable to Option Agreements Established by Judge Greene in the *Tel-Optik Decision*

  -- While the decisions of the Decree Court are not controlling, they are persuasive authority for interpreting the provisions of the Telecommunications Act that preserved the Decree's inter-LATA prohibition

    * The foundation of the *Tel-Optik* decision was Judge Greene's conclusion that inter-LATA prohibition was designed to prevent the BOCs from using their "control of bottleneck facilities to disadvantage . . . entities doing business in competitive markets"

    * In implementing this restriction, Judge Greene recognized, "*manipulations of form should not obscure the real economic incentives underlying . . . a particular business relationship*"

    * The three-part test was a pragmatic effort to assess whether a particular arrangement would undermine the goals inter-LATA prohibition by giving a BOC an "economic incentive" to discriminate in favor of the entity with which it entered into an contingent purchase agreement

    * There is no reason to believe that Congress intended to adopt a less rigorous approach than the Decree Court's: while Congress used the narrower term "affiliate" (rather than "affiliated enterprise"), it significantly broadened the definition by lowering the equity threshold from 50.1 to ten percent

-- Verizon's investment in Genuity would not be "minor" either absolutely or comparatively; the proposed $1.3 billion investment would be:

  * 130 times larger than the $10 million investment in *Tel-Optik*

  * equal to 2.3 percent of Verizon's revenues – almost five times larger than the proportion that Judge Greene found would "fall *just within* the category of investments that this court is prepared to regard as 'minor'"

-- There is no "genuine question" that Genuity would exercise the option – which, unlike the *Tel-Optik* option, would not require any additional payments

-- Unlike in *Tel-Optik*, there would not be adequate procedural safeguards to deter BOC discrimination

  * Unlike the Decree Court, the Commission would not have an opportunity to approve the exercise of the option

  * As explained above, the Section 271 application review process would not provide an adequate deterrent to discrimination in favor of Genuity

- The Commission Should Require Verizon to Divest Genuity; If Verizon Wants an Option to Repurchase Genuity, the Agreement Must Satisfy Two Conditions:

  -- The Agreement must be *genuinely* contingent; Verizon must have real uncertainty as to whether it ultimately would obtain an equity interest in excess of ten percent in Genuity

  -- The Agreement must not allow Verizon to capture Genuity's appreciation, cost-free, during the period prior to the exercise of the option